STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

WISCONSIN ENERGY CORPORATION, INTEGRYS ENERGY GROUP, INC., PEOPLES ENERGY, LLC, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, ATC MANAGEMENT INC., and AMERICAN TRANSMISSION COMPANY LLC	)	
Application pursuant to Section 7-204 of the Public Utilities Act for authority to engage in a Reorganization, to enter into agreements with affiliated interests pursuant to Section 7-101, and for such other approvals as may be required under the Public Utilities Act to effectuate the Reorganization.	)	Docket No. 14-_________

Direct Testimony of

JOHN J. REED

CEO – Concentric Energy Advisors, Inc.

On Behalf of
Wisconsin Energy Corporation

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I. INTRODUCTION AND PURPOSE

Q. Please state your name, affiliation, and business address.

A. My name is John J. Reed. I am Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. ("Concentric") and CE Capital, Inc. located at 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. On whose behalf are you submitting this testimony?

A. I am submitting this testimony on behalf of Wisconsin Energy Corporation ("WEC").

Q. Please describe your educational background and professional experience in the energy and utility industries.

A. I have more than 35 years of experience in the energy industry, and have worked as an executive in, and consultant and economist to, the energy industry. Over the past 26 years, I have directed the energy consulting services of Concentric, Navigant Consulting, and Reed Consulting Group. I have served as Vice Chairman and Co-CEO of the nation's largest publicly-traded consulting firm and as Chief Economist for the nation's largest gas utility. I have provided regulatory policy and regulatory economics support to more than 100 energy and utility clients, and have provided expert testimony on regulatory, economic, and financial matters on more than 150 occasions before the Federal Energy Regulatory Commission ("FERC"), Canadian regulatory agencies, state utility regulatory agencies, various state and federal courts, and before arbitration panels in the United States and Canada. My background is presented in more detail in Joint Applicants Exhibit 3.1.

Q. Please describe Concentric's and CE Capital's activities in energy and utility engagements.

A. Concentric provides financial and economic advisory services to many and various energy and utility clients across North America. Our regulatory economic and market analysis services include utility ratemaking and regulatory advisory services, energy market assessments, market entry and exit analysis, corporate and business unit strategy development, demand forecasting, resource planning, and energy contract negotiations. Our financial advisory activities include both buy and sell side merger, acquisition and divestiture assignments, due diligence and valuation assignments, project and corporate finance services, and transaction support services. In addition, we provide litigation support services on a wide range of financial and economic issues on behalf of clients throughout North America. CE Capital is a fully registered broker-dealer securities firm specializing in merger and acquisition activities. As CEO of CE Capital, I hold several securities licenses that cover all forms of securities and investment banking activities.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to address how WEC's proposed acquisition of Integrys Energy Group, Inc. ("Integrys") (the "Transaction") is in the best interests of utility customers, investors and the public. Specifically, I will address three primary areas: (1) recent industry trends and economic and financial market conditions that have driven consolidation within the utility industry, the key drivers of consolidation and how the proposed Transaction is consistent with that current market context; (2) the expected benefits of the proposed Transaction to the customers and investors of WEC and Integrys (collectively the "Companies"), and to the general public; and (3) why the Transaction should be approved by the Illinois Commerce Commission (the "Commission") as proposed.

Q. Did Concentric or CE Capital provide any advisory services to the proposed Transaction before it was announced?

A. No. We have been retained as consultants and experts to assist in the approval process for the Transaction.

Q. How is the remainder of your testimony organized?

A. Section II of my testimony provides a brief overview of the Transaction, including the objectives of the Transaction and the commitments and conditions made by WEC. Section III provides an overview of recent utility industry trends, to provide context and insight into the underlying strategic, economic and regulatory drivers that encourage transactions such as the proposed Transaction. Additionally, I present an overview of utility industry consolidation over the long-term, and show how that trend has changed the utility sector over time. Section IV reviews the reaction of the credit rating agencies to consolidation in the utility industry in general, and WEC, Integrys, their operating companies, and the Transaction in particular. Section V summarizes my understanding of the Commission's standard for approving a merger like this Transaction. Section VI describes the specific strategic, customer, and financial benefits of the Transaction. Section VII explains how the Transaction satisfies the Commission's standard. Section VIII provides my conclusions and recommendations.

II. OVERVIEW OF THE TRANSACTION

Q. Please briefly describe the Transaction.

A. On June 22, 2014, the Companies entered into an agreement pursuant to which WEC would acquire 100% of the outstanding common stock of Integrys. Upon completion of the Transaction, the combined company will be called WEC Energy Group. All utility subsidiaries of WEC and Integrys (except Upper Peninsula Power Company),[1] including Wisconsin Electric Power Company ("WEPCO") and Wisconsin Gas LLC ("WG") (both doing business as "We Energies"), Wisconsin Public Service Corporation ("WPS"), The Peoples Gas Light and Coke Company ("Peoples Gas"), North Shore Gas Company ("North Shore Gas"), Minnesota Energy Resources Corporation ("MERC"), Michigan Gas Utilities Corporation ("MGU")will remain as subsidiaries of WEC Energy Group. As discussed below, WEC Energy Group will hold 60.31% ownership in American Transmission Company LLC ("ATC").

Integrys shareholders will receive total consideration of $71.47 per share which, combined with the assumption of Integrys debt and excluding non-regulated businesses represents a premium of 55% over Integrys' estimated 2015 rate base.[2] The total value of the Transaction is estimated at $9.1 billion: $5.8 billion for Integrys shares and $3.3 billion of assumed Integrys debt. WEC will finance the Transaction by issuing new WEC stock and by WEC issuing approximately $1.5 billion in new acquisition debt.

In performing the due diligence necessary to properly consider the proposed Transaction, WEC engaged Standard & Poor's ("S&P") and Moody's Investor Services

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[1] Integrys is in the late stages of selling UPPCO to Balfour Beatty Infrastructure Partners LP.

[2] Integrys shareholders will receive 1.128 WEC shares plus $18.58 in cash for each Integrys share. See, Wisconsin Energy to Acquire Integrys Energy Group, Company Presentation, June 2014, at 15 and 26. Valuation based on June 20, 2014 closing price.

("Moody's") (collectively with Fitch Ratings ("Fitch") the "Credit Rating Agencies") to review the terms of the Transaction and to confirm the expected effect of the Transaction on the credit metrics and credit ratings of the combined company.[3] As noted in the Application and as discussed in more detail in Section III of my testimony, the Credit Rating Agencies have evaluated the impact of the Transaction on credit quality, and have reaffirmed the current credit ratings for the operating utility subsidiaries after the finalization of the Transaction. While Moody's has changed the ratings "outlook" for WEC (the parent company) to negative and Fitch has changed WEC's credit rating to "Rating Watch Negative," Moody's has also indicated that the long-term effect of the Transaction is likely to be beneficial, particularly for Integrys.

Each of the boards of directors of WEC and Integrys gave its unanimous approval for its company's participation in the Transaction. Both WEC and Integrys will schedule shareholder votes to seek approval of the Transaction from their common equity shareholders. Both shareholder votes are expected to be held in the fourth quarter of 2014. The Companies each expect that its shareholders will find this proposed Transaction to be in the Company's best interests and will vote to approve the Transaction.

Please refer to the testimony of WEC's witness, Allen Leverett, for a more detailed discussion of the Transaction.

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[3] WEC engaged S&P and Moody's prior to the merger and compensated them for their reviews. Integrys provided consent for doing the analysis.

Q. What are the key characteristics of the combined WEC Energy Group?

A. WEC Energy Group will be one of the largest utility holding companies in the country, with a combined rate base of about $17 billion, serving approximately 4.3 million customers across Wisconsin, Illinois, Michigan and Minnesota. On a consolidated basis, WEC Energy Group will rank approximately 14th among public utilities in the country in terms of market value and 15th in terms of gas and electric customers. The combined company will have approximately 2.8 million gas distribution customers and 1.5 million electric utility customers. Based solely on the gas utility customer count, WEC Energy Group will be larger than all but seven gas utilities nationally.

Integrys has announced a proposed sale of the retail electricity and natural gas supply portion of Integrys Energy Services, Inc. ("IES") to Exelon Corp. That divestiture is expected to close no later than the first quarter of 2015. WEC Energy Group will continue to own and operate IES's solar asset development and management business (currently part of IES), Trillium CNG, a leading provider of compressed natural gas fueling services, and Integrys Business Support, LLC ("IBS"), a centralized service company that, shortly after the Transaction's closing, will be renamed "WEC Business Services, LLC" ("WBS").

As noted earlier in my testimony, on a consolidated basis, WEC Energy Group also will retain a 60.31% ownership stake in ATC.

As the Companies have stated in their announcement of the Transaction, "[t]he combination of Wisconsin Energy and Integrys brings together two strong and well-regarded utility operators with complementary geographic footprints to create a larger, more diverse Midwest electric and natural gas delivery company with the operational expertise, scale and financial resources to meet the region's future energy needs."[4]

Q. Is WEC seeking recovery of the Transaction's acquisition premium?

A. No. WEC is not seeking the recovery of the acquisition premium from regulators in any state or at the FERC.

Q. Is WEC seeking recovery of transaction costs?

A. No. To be clear, transaction costs are the various costs and fees incurred in connection with the execution of the Transaction (e.g., banker fees, legal fees, etc.). WEC will not seek approval to recover these transaction costs from any state regulator or the FERC.

Q. Is WEC seeking recovery of transition costs?

A. Savings that are realized over time, and the recovery of transition costs necessary to achieve those savings, will be addressed through the future rate case processes in each state.

Q. Is WEC planning any changes in the combined company's presence and workforce in the communities it serves?

A. No. WEC is committed to maintaining a local presence in the communities currently served by the combined company's operating utilities. The Transaction will be seamless for Illinois customers. Peoples Gas and North Shore Gas (1) will continue as separate operating utilities, (2) will maintain their respective names, and (3) will maintain their operating headquarters in Chicago and Waukegan, respectively. WEC is not planning the

[4] See, Wisconsin Energy to acquire Integrys Energy Group for $9.1 billion in cash, stock and assumed debt - creating a leading Midwest electric and gas utility, Press Release, June 23, 2014.

sort of reductions in force that occur in many corporate consolidations. In fact, WEC has committed to (1) maintain 1,953 full-time equivalent ("FTE") employee positions in the State of Illinois for two years after the Transaction closes, (2) will honor the Gas Companies' existing labor agreements, and (3) maintain the Gas Companies' commitments to worker training for the same two year period. WEC expects that the vast majority of any reductions in the labor force of WEC Energy Group will occur over time through natural attrition and voluntary separation.

Q. Will the Transaction have any near-term impact on rates?

A. No. No changes to the Gas Companies' rates are proposed at this time as a result of the Transaction. As discussed in the application, WEC has committed that Peoples Gas and North Shore Gas will not seek increases of base rates that would become effective earlier than two years after the Transaction closes, which is not likely to occur prior to July 2015. The effect of this commitment, therefore, will be that the Gas Companies' new base rates will be fixed for a period of well over two years from the time that they are expected to become effective in their pending rate cases. As discussed in more detail later in my testimony and in the testimony of Mr. Leverett, this Transaction is not based on expected short-term savings sometimes seen in mergers, which generally have occurred as the result of significant layoffs. Efficiencies are expected to be identified and realized over time, with no meaningful net savings expected in the near term. Savings that are realized over time, and the transition costs necessary to achieve those savings, will be reflected through the future rate case processes in each state.

Q. Will WEC Energy Group have affiliate interest agreements in place governing the sharing of services between regulated and non-regulated operations?

A. Yes. As discussed in more detail in Mr. Lauber's testimony, WEC and its affiliates currently share services pursuant to various agreements approved in the jurisdictions in which they currently operate. Integrys and its operating companies, including IBS, provide services to one another pursuant to Commission-approved affiliate interest agreements. WEC is seeking the Commission's approval of a new affiliate interest agreement that reflects the merger and allows WEC and Integrys companies (other than WBS) to provide services to one another where it is in customers' best interests to do so. Additionally, WEC and its affiliates will enter into separate agreements with WBS that allow them to obtain services from WBS, but those agreements should not need Commission approval because no Illinois public utility will be party to those agreements.

Q. Has WEC agreed to any conditions applicable to its majority ownership in ATC?

A. Yes. As discussed by Mr. Leverett, WEC is committing to the FERC that following the closing of the Transaction, WEC Energy Group will vote its ownership stake in ATC in such a way as to maintain the current diversity of views on the direction and management of ATC.

Q. Please summarize the benefits the Transaction will create.

A. As discussed in more detail in Section VI, below, the Transaction will create a larger, more diversified and financially strong energy company with a strong operational and management presence in Illinois, benefiting customers, employees, shareholders and the communities and region in which it operates. The significant scale of WEC Energy Group will better equip it to compete and maintain its independence in the rapidly changing and capital-intensive energy business. The strong cash flow of the combined company can be prudently invested in needed energy infrastructure, including the environmental retrofits, moving gas meters from the inside to the outside of customers' premises, gas main replacements and investment in new technologies that are included in Integrys' five-year plan to invest $3.5 billion in infrastructure and operations. Over the long-term, WEC Energy Group's increased financial scale and strength will promote enhanced access to capital to fund the ongoing initiatives of the combined company.

The Transaction will result in increased customer base/composition, geographic, asset (including generation assets), operational and regulatory diversification. This diversification will better enable WEC Energy Group to meet the challenges of a rapidly changing energy industry, through sharing best practices across its operating territories, the ability to benefit from the combined company's large and expert workforce across its system, and the opportunity to create efficiencies over time. The positive impact of diversification and operational opportunities, along with WEC's commitments regarding their active local presence and workforce, will produce significant local and regional economic benefits as compared to either independent operation or as part of another merger with a different acquirer with a different focus.

Creating a utility holding company with the strength, scale and breadth that WEC Energy Group will have, will enable it to continue to provide its customers with safe, reliable and affordable utility service, appropriately compensate its shareholders, continue the Companies' long tradition of making significant contributions to the communities they serve, act as a leader in the energy industry and continue to constructively contribute to energy policy in Illinois and the nation. Importantly, the

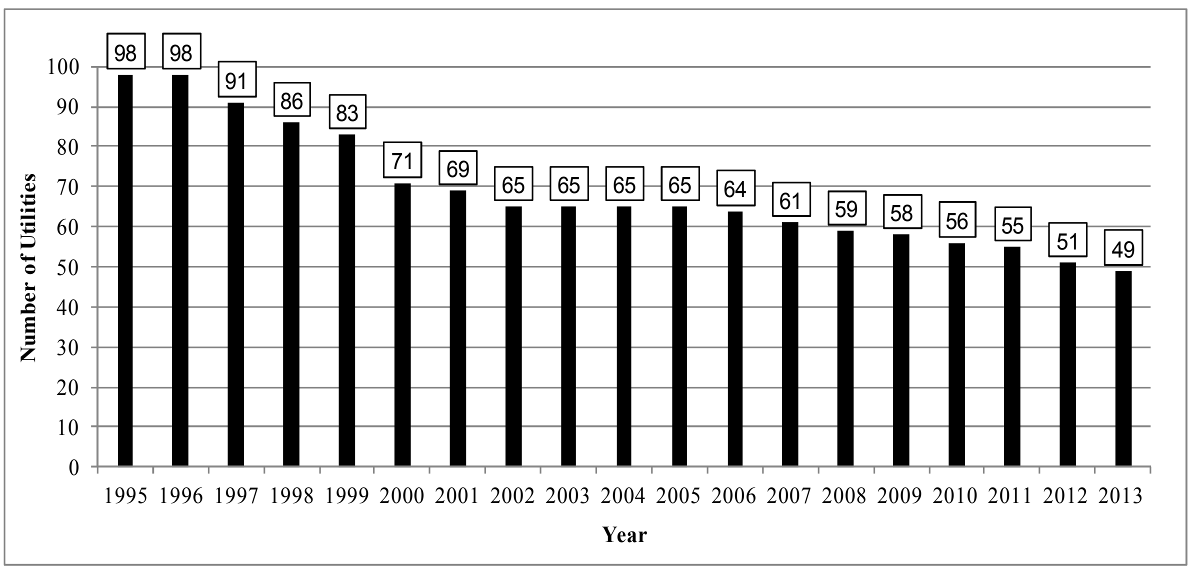
Transaction will enable WEC Energy Group to achieve these benefits for customers, investors and the public.

III. RECENT INDUSTRY TRENDS AND UTILITY INDUSTRY CONSOLIDATION

Q. Please describe the state of mergers and acquisitions in the utility industry.

A. The utility industry has been steadily consolidating for some time. As shown in Chart 1, since 1995, the number of electric investor-owned utilities ("IOUs") has declined by 50 percent, from 98 companies at the beginning of 1995 to 49 companies as of December 2013.

Chart 1: U.S. Investor-Owned Electric Utilities 1995-2013[5]

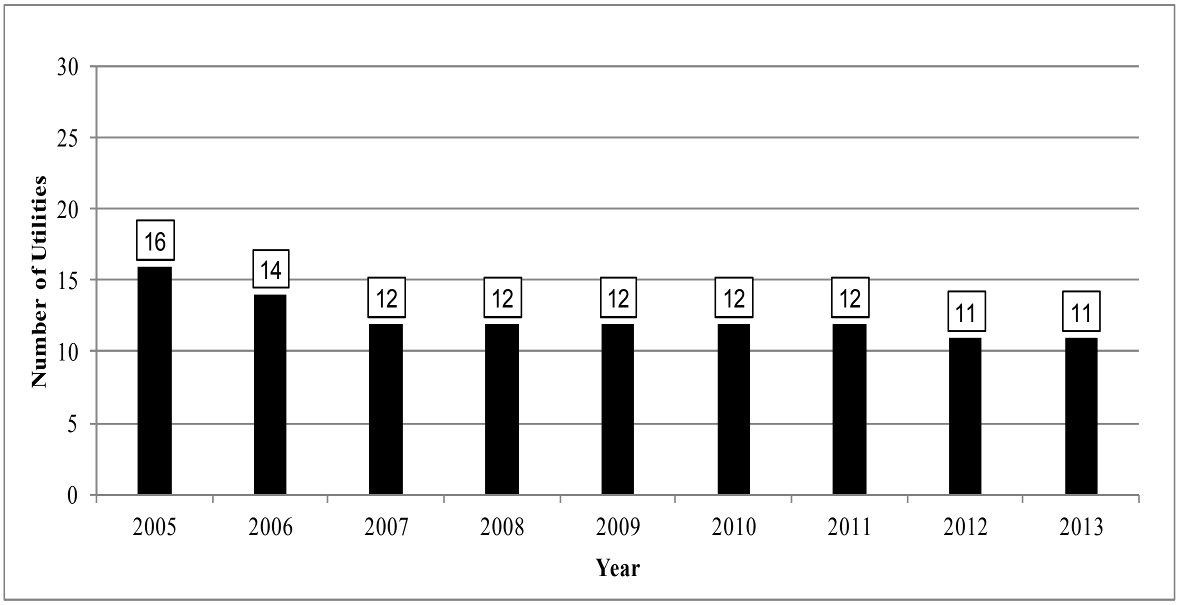


Similarly, the number of natural gas distribution IOUs has declined by approximately 31 percent, from 16 companies in December 2005 to 11 companies as of December 2013. Moreover, as pointed out by Daniel Fidell, a utility analyst at U.S.

[5] Source: EEI 2013 Financial Review, at 41.

Capital Advisors, the merger and acquisition trend from 2004-2011 "typically consisted of a larger electric utility acquiring a smaller gas utility."[6]

Chart 2: U.S. Investor-Owned Natural Gas Distribution Utilities 2005-2013[7]



Q. What trends in the industry are driving this consolidation?

A. Industry trends such as stagnant demand or declining customer usage and increased capital spending for investments that do not increase the quantities of electricity or natural gas sold (e.g., environmental retrofits on existing electric generators), as well as weak economic conditions over the past several years have stretched utility balance sheets and placed pressure on credit metrics, contributing to utilities seeking strategic mergers to increase their size and improve their overall financial strength.

Current and projected capital needs of utilities are driven by expenditures that are not growth oriented and, absent rate increases, do not produce additional revenues. The magnitude of these investments often requires utilities to seek access to capital markets.

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6 "U.S. Capital Advisors breaks down attractive utility M&A targets," SNL Financial, July 9, 2014.

7 Source: Value Line Investment Survey, December edition of each year shown.

At the same time that utilities are facing increased capital requirements, projected market conditions are such that the era of extraordinarily low debt costs, which has benefited all utilities, is likely coming to an end. As interest rates rise and the cost of both debt and equity increase, utilities with stronger balance sheets and higher credit ratings will have access to capital at more favorable terms, all of which will benefit customers and shareholders.

The trend toward industry concentration highlights one important reason that mid-sized investor-owned utilities, such as WEC and Integrys, would consider merging or being acquired. In particular, by becoming part of a larger company, mid-sized companies can continue to compete effectively with larger entities for debt and equity capital to finance their capital needs.

Q. Please explain why growth prospects are more challenging for utilities in the current environment.

A. Electric and natural gas utilities have faced stagnant demand growth in recent years resulting from a combination of weak economic conditions and demand reductions due to energy efficiency and on-site generation measures. In a report issued immediately following the announcement of the Transaction, the utility industry investment analyst for the investment firm Sanford Bernstein highlighted this trend, noting:

> My basic view is that the pressures behind consolidation will remain strong and may be getting stronger. I see those pressures as being stagnant power demand… Over the last five years, I think power demand is down by a percent and yet utilities have been investing in rate base, so they're

probably looking at a base of invested capital that could be 10% to 20% higher than it was five years ago.[8]

The declining demand in some jurisdictions and the slow growth in other jurisdictions, combined with general increases in operating costs have placed pressure on utilities' cash flows, balance sheets, and credit metrics.

Q. How do capital investment plans affect utilities' financial strength?

A. Utility capital investment plans include significant infrastructure enhancement and environmental compliance components, which often require access to debt or equity markets. Capital investments include replacement of aging infrastructure (e.g., gas mains), environmental upgrades to comply with current and expected government rules and regulations, necessary transmission and distribution expansion for renewable energy integration and system reinforcement, and investments in new and emerging technologies, all of which are necessary to maintain and improve the distribution system. Since infrastructure enhancements and environmental compliance investments do not result in a larger customer base or increased sales, these investments do not generate any incremental revenue to offset the additional capital financing requirements without an increase in customer rates. For smaller and mid-sized electric and natural gas utility companies, the magnitude of these non-revenue producing capital financing requirements can place significant strain on the company's financial position and rates.

[8] "With M&A apace in 2014, Bernstein outlines other potential utility M&A combos," SNL Financial, June 27, 2014.

Q. How have recent economic conditions affected the utility industry?

A. Economic conditions have been weak in recent years. The severe recession and credit crisis of 2008-2009 has been followed by a period of slow economic growth in the U.S. These weak economic conditions have contributed to stagnant demand growth for electric and natural gas utility companies, while capital investment requirements for utilities have increased. Moody's notes that since the financial crisis, credit quality has been a key factor driving utility mergers[9], as utilities seek strategic combinations that will allow them to attract capital to finance capital investments during a period of weak economic growth and stagnant demand growth.

At the same time, interest rates have risen over the past year, and the expectation among investors is for that trend to continue as the Federal Reserve winds down the extraordinary Quantitative Easing program that has been in place since the financial crisis of 2008-2009.[10] As interest rates rise and the cost of both debt and equity increases, utilities with stronger balance sheets and higher credit ratings will have access to capital on more favorable terms, all of which benefits customers and shareholders.

Q. Have mergers and acquisitions reshaped the utility industry?

A. Yes. Industry consolidation has resulted in significant concentration among the largest IOUs. Examples include: Duke Energy Corp/Progress Energy Inc.; Exelon Corp/Constellation Energy, Inc.; Northeast Utilities/NSTAR LLC; and AGL Resources/NICOR. Ongoing industry consolidation has resulted in the formation of much larger utility holding companies over the past decade.

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[9] Moody's Investors Service, "A Rating Agency Perspective on the Utility Industry," June 25, 2012, p. 24.

[10] Blue Chip Financial Forecasts, Vol. 33, No. 6, June 1, 2014, at 14.

Q. Is there an expectation that large-scale mergers will continue to dominate the utility industry?

A. No. While large-scale mergers have resulted in the formation of some extremely large utility holding companies, more recent expectations with respect to ongoing industry consolidation have focused on mid-sized companies. Industry analysts project that trend to continue and have identified several mid-sized companies that may be attractive for acquisition. In June 2014, shortly after the announcement of this Transaction, several medium-sized utilities were identified as consolidation candidates, including: UIL Holdings Corp.; Empire District Electric Co.; Portland General Electric Co.; El Paso Electric Co.; IDACORP Inc., Great Plains Energy Inc.; Avista Corp.; Westar Energy Inc.; Pinnacle West Capital Corp.; and ALLETE, Inc.[11]

Q. Are synergies the primary driver of many recent utility mergers?

A. No, frequently this is not the case. Drivers for individual mergers have advanced beyond the search for synergies and operational economies of scale. Recent mergers and acquisitions reflect the importance of geographic diversification and financial strength in the utility industry. For example, in reviewing major utility mergers that have occurred since 2004, of 27 mergers reviewed, 18 mergers were approved without the filing of a comprehensive synergy study supporting the merger. For those 18 examples, drivers other than synergy savings were the primary reasons for the merger. Examples of these types of mergers include the Fortis acquisition of UNS Energy Corp., the Berkshire Hathaway subsidiary, MidAmerican Energy Holdings Co. ("MidAmerican"), acquisition

[11] "With M&A apace in 2014, Bernstein outlines other potential utility M&A combos," SNL Financial, June 27, 2014.

of Nevada Power, the Puget Holdings LLC[12] acquisition of Puget Energy, the TECO Energy acquisition of New Mexico Gas, the Laclede Group, Inc. acquisition of Alabama Gas Corporation, and the AGL Resources acquisition of NICOR Inc.

Q. What were the primary drivers behind each of those transactions?

A. In each case, the dominant purchaser in those transactions was not seeking to capture immediate synergies (i.e., cost savings and economies of scale) through the combination of local operations. Rather, the acquiring company in each of those transactions was seeking to achieve a number of benefits, including increased scale and scope, enhanced access to capital for the acquired utility company, increased funding for infrastructure-related capital expenditures, and diversification (including customer base/composition, geography, assets, including generation assets, and operations). This is very consistent with the drivers behind the Transaction proposed by WEC and Integrys.

Q. Please provide some specific examples of financial and capital investment-related drivers for mergers.

A. The following summarizes the capital investment issues discussed in several of the above transactions:

- MidAmerican indicated that the merger would benefit NV Energy and its customers through increased financial stability, lower debt costs and increased access to capital that would be needed to make new generation and transmission investments.[13]

[12] Puget Holdings LLC was comprised of a group of long-term infrastructure investors including Macquarie Infrastructure Partners.

[13] SNL Energy, Update: "MidAmerican, NV Energy close merger after gaining FERC's approval," December 19, 2013.

- Puget Holdings committed to support Puget Energy and its wholly-owned subsidiary, Puget Sound Energy's $5 billion capital program for infrastructure projects to maintain and improve the utility's reliability, in addition to other savings.
- In Fortis's acquisition of UNS Energy, UNS Energy cited the importance of Fortis' financial strength, which would "improve UNS Energy's access to capital to fund the ongoing diversification of its generating fleet as well as other infrastructure investments. Upon closing, Fortis will inject $200 million into UNS Energy to strengthen its balance sheet and help fund the planned purchase of Unit 3 of the natural gas-fired Gila River Power Plant, a transaction that will reduce TEP's [UNS Energy's operating utility] reliance on coal-fired power."[14]
- AGL Resources indicated that it had strong investment-grade credit ratings and substantial financial resources, and that the merger with NICOR would give Northern Illinois Gas a larger financial platform for making investments to maintain safety and improve reliability and customer service.[15]

In each of these examples, the financial strength of the resulting combined company was a significant driver of the rationale for a merger. Likewise, WEC Energy Group will benefit from similar increased financial strength and flexibility.

Q. How do utility companies evaluate the need for increased diversification?

A. Companies examine their operating segments and growth prospects and seek to mitigate and manage the risks associated with those subsidiaries. Risks may be mitigated either through diversification or the acquisition of a company that has a different risk profile. Avista Corp's plan to acquire Alaska Energy Resources Co., TECO Energy's acquisition of New Mexico Gas Company, UIL Holdings purchase of three gas utility companies

[14] "UNS Energy Agrees to Be Acquired by Fortis Utility Group; Acquisition Would Strengthen Local Arizona Utilities," UNS Energy Corporation, December 11, 2013.

[15] Docket No. 11-0046, Illinois Commerce Commission, December 7, 2011, Order at 4.

from Iberdrola, and the Northeast Utilities and NSTAR merger are additional examples of transactions where diversification was a key driver.

- Avista Corp/Alaska Energy Resources - Avista stated that its strategy in this acquisition was to expand and diversify its energy assets.

- TECO Energy/New Mexico Gas Co. - TECO Energy had seen declining revenue resulting from warm weather and low natural gas prices, which depressed coal prices. TECO Energy stated publicly that this transaction would increase its customer base by 50 percent, provide future growth in an "attractive Sunbelt location"[16], increase the percentage of earnings from regulated operations, and reduce earnings volatility.

- UIL Holdings/Iberdrola gas utilities, Berkshire Gas Co., CT Natural Gas Corp., and Southern Connecticut Gas Co. – UIL, a Connecticut electric utility company, requested authorization to purchase three natural gas utilities in contiguous and complementary locations, without the filing of a synergy study. UIL noted that the merger would create a larger, diversified energy delivery company, with a diversified revenue mix, and differentiated peaking seasons that levelize earnings and cash flow.[17]

- Northeast Utilities/NSTAR – The primary focus of the Northeast Utilities and NSTAR merger, two gas and electric utilities with complementary operating territories, was on the expansion of scope with respect to financial capability, geographic diversity and best practices, not on the achievement of immediate synergy savings.[18]

[16] See, TECO Energy Announces Agreement to Acquire New Mexico Gas Company, Press Release, May 28, 2013.

[17] UIL Acquisition of SCG, CNG & The Berkshire Gas Company, Investor Presentation, May 25, 2010.

[18] See, Joint Testimony of James J. Judge and David R. McHale, DPU 10-170, Massachusetts Department of Public Utilities, November 24, 2010. I note that pursuant to a change in merger approval standards in Massachusetts during this proceeding, Northeast Utilities and NSTAR filed a supplemental synergy savings analysis that demonstrated expected savings from the merger.

Q. What is your conclusion with regard to whether the factors underlying the proposed Transaction are consistent with recent consolidation within the utility industry?

A. My conclusion is that the factors underlying the proposed Transaction are consistent with recent consolidation within the utility industry. In particular, the proposed Transaction combines neighboring utility companies with complementary markets and adjacent service territories, while providing geographic and customer diversification. If the proposed Transaction is approved, customers will receive the benefits of the combined company, while continuing to enjoy local management and a local presence in the communities served by the various operating utilities. Further, as a result of the proposed Transaction, the combined company will have enhanced scale and financial strength, thereby allowing it to compete for capital on reasonable terms to fund the capital investment requirements of the various operating utilities.

IV. <u>REACTIONS OF THE CREDIT RATING AGENCIES</u>

Q. Have credit rating agencies offered any perspective on consolidation in the utility industry?

A. Yes. Both Moody's and S&P expect that utility mergers will continue. In a 2012 presentation, Moody's concluded that the rationale for utility industry consolidation is "compelling", citing several motivating factors: (1) building scale and scope; (2) spreading fixed costs over larger asset platforms; (3) capturing operating efficiencies; (4) diversification of business and operating risks and geographic and weather exposure; (5) combining complementary operations; (6) generating financing efficiencies/access to capital markets; (7) growth in earnings; (8) addressing rising operating costs; (9) meeting demand for infrastructure-related capital expenditures; and (10) better management of larger projects.[19]

S&P also projects that utility mergers will continue, as utilities seek to create larger, more diverse and more efficient organizations that have better credit profiles and superior access to capital.[20]

Q. What are the primary factors that affect the credit ratings of the parties in merger transactions?

A. Rating agencies look closely at the structure of mergers and acquisitions involving electric and natural gas utility companies to determine the overall effect on credit ratings. To the extent that the acquiring company's balance sheet takes on significant incremental debt as a result of the transaction, or the concessions required by regulators place pressure on cash flow metrics, rating agencies have tended to downgrade the acquired company. Conversely, acquisitions that place the acquired company in a more favorable financial position to be able to meet its ongoing capital needs have resulted in a credit upgrade or the expectation of future increases in credit ratings for the acquired company.

Q. Please provide examples of recent mergers that resulted in improved credit ratings or a positive ratings outlook for the acquired company.

A. There are several recent mergers that have resulted in improved credit ratings or a positive ratings outlook for the acquired company, including mergers that were not based on synergies and cost savings. In most cases, the acquiring company had a stronger

[19] Moody's Investors Service, "A Rating Agency Perspective on the Utility Industry," June 25, 2012, p. 24.

[20] Standard & Poor's RatingsDirect, "Opportunity for U.S. Regulated Electric Utility Mergers in the U.S. Still Exists," March 12, 2012.

credit rating than the acquired company, resulting in a credit rating upgrade or a positive outlook for the acquired company.

- Berkshire Hathaway/NV Energy – The acquisition of NV Energy by MidAmerican Energy Holdings, a subsidiary of Berkshire Hathaway, was based on geographic diversification and enhancing the financial strength of the combined company. S&P and Fitch both upgraded NV Energy following the closing of the acquisition by MidAmerican Energy Holdings. Fitch indicated that "the one-notch upgrade of [NV Energy] and its utility operating subsidiaries ratings and the stable outlook is supported by the increased financial flexibility and lower funding costs afforded [NV Energy] and its subsidiaries by association with a larger, financially strong parent company."[21]
- FirstEnergy/Allegheny - Prior to the merger, Moody's rated FirstEnergy Baa3 and Allegheny as Ba1. After the merger, Moody's upgraded Allegheny to Baa3. Fitch also revised the rating outlook for Allegheny Energy to positive from stable, stating that "Fitch recognizes the strategic benefits of the transaction which would combine geographically contiguous and complementary regulated utilities and competitive businesses."[22]
- WPS Resources/Peoples Energy Corporation – Moody's upgraded Peoples Energy Corporation's senior unsecured debt rating from Baa2 to A3 following the closing of the acquisition. Moody's stated: "The two-notch upgrade for Peoples reflects its new ownership and support by a solid utility parent company."[23]
- Gaz Metro/Central Vermont Public Service – Moody's upgraded Central Vermont Public Service from Baa3 to Baa2 after the merger with Gaz Metro was completed. Moody's offered the following rationale for the upgrade: "the rating changes reflect our expectation for the combined utility to produce financial

[21] SNL Financial, "Fitch upgrades NV Energy after MidAmerican acquisition," December 23, 2013.

[22] SNL Financial, "Rating agencies weigh in on FirstEnergy/Allegheny Energy merger," February 11, 2010.

[23] Moody's Investors Service, "Moody's upgrades Peoples Energy Corp.," February 21, 2007.

metrics, including the ratio of cash flow from operations to debt, in the mid to high teens over the intermediate period."[24]

Q. How have regulatory conditions and requirements on mergers and acquisitions affected credit ratings?

A. Some regulators have required merger applicants to provide certain regulatory concessions or commitments that have negative financial implications for the acquired utility. Depending on the magnitude of the conditions and requirements, there can be negative implications for cash flow metrics and other factors that are considered in establishing a company's credit rating. For example, as a result of conditions placed on the Northeast Utilities/NSTAR merger in Connecticut, Moody's downgraded the ratings outlook for Connecticut Light and Power ("CL&P"), citing concerns that the base distribution rate freeze and the agreement to defer recovery of storm costs over a six year period were less credit supportive.[25] Once the merger was completed, Moody's downgraded CL&P from Baa1 to Baa2.[26] Similarly, merger conditions in Massachusetts resulted in Moody's placing NSTAR Electric on review for possible downgrade. Moody's noted that the four-year rate freeze allowed for storm cost recovery, but deferred that recovery for more than two years. In Moody's view, this could lead to an increase in indebtedness and reduce margins for NSTAR Electric, which would likely

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[24] SNL Financial: "Moody's takes diverging views on GMP, CVPS after merger approval in Vermont," June 25, 2012.

[25] SNL Financial: "Moody's lowers outlook on NU's CL&P subsidiary," March 16, 2012.

[26] Moody's Investors Service, "Moody's downgrades NSTAR, NSTAR Electric, and Connecticut Light & Power; affirms NU and its other subsidiaries," April 9, 2012.

weaken credit metrics in the future.[27] After the merger closed, NSTAR Electric was downgraded by Moody's from A2 to A1.[28]

Q. How have the Credit Rating Agencies responded to WEC's proposed acquisition of Integrys?

A. As I noted above, the Credit Rating Agencies evaluated the impact of the Transaction on credit quality, and reaffirmed the current credit ratings for WEC, Integrys and all of the operating utility subsidiaries. The Credit Rating Agencies have generally viewed the Transaction as positive for Integrys and slightly negative over the short-term for WEC (the parent holding company).

Moody's did change its ratings "outlook" from stable to negative for WEC, citing Moody's expectation that the Transaction would cause deterioration in WEC's credit profile as it is acquiring a company with a weaker credit profile in a leveraged transaction. Over the next three years, Moody's notes that the ratios of cash flow from operations before working capital adjustments to debt and retained cash flow to debt for WEC are expected to fall. At the same time, however, Moody's expressed a favorable overall view of the Transaction:

> Upon the completion of the transaction, WEC will benefit from the larger size and the complementary nature of the operations of the combined group in Wisconsin as well as from a more diversified footprint in operational and geographical reach. The latter factors Integrys' multi-state operations and its significant natural gas distribution operations in Illinois…[29]

[27] SNL Financial: "Moody's places NSTAR ratings on review for downgrade," February 16, 2012.

[28] Moody's Investors Service, "Moody's downgrades NSTAR, NSTAR Electric, and Connecticut Light & Power; affirms NU and its other subsidiaries," April 9, 2012.

[29] "Moody's changes Wisconsin Energy outlook to negative following Integrys deal," SNL Financial, June 24, 2014.

Concurrently, Moody's put the long-term ratings of Integrys under review for upgrade after the company disclosed that it is in the late stages of a competitive process to divest its unregulated retail operations. After Integrys announced that it had reached a definitive agreement to sell IES to Exelon, Moody's commented: "The sale is credit positive for Integrys because it removes a source of cash flow volatility and the risk for large, unexpected demands on liquidity." [30] Finally, Moody's affirmed certain ratings of WEC and Integrys, including their operating utility subsidiaries.

S&P affirmed its existing ratings for WEC, Integrys and all of the Companies' respective operating utilities. S&P concurrently reduced the outlook of WEC, Integrys and Integrys' subsidiary companies Peoples Gas and North Shore Gas to "negative" from "stable," noting "[d]ue to WEC's plans to fund the transaction with a combination of debt and common stock, we believe that the company's financial measures could fall to the weaker end of our "significant" financial risk profile category based on our medial volatility table, leaving little cushion for underperformance relative to our forecast."[31] The ratings outlook of WG, WEPCO, and WPS remain stable because, as noted by S&P, "[r]atings stability for WEPCO, WG, and WPS reflects sufficient regulatory insulation and their stand-alone credit profiles, which would be unaffected by the transaction."[32]

Fitch had a similar reaction to the Transaction, placing WEC on "Rating Watch Negative" due to concern about the need to issue $1.5 billion in new debt at the holding company level to finance the cash portion of the acquisition. Fitch noted that the ratings

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[30] Moody's Investors Service, "Integrys Sale of Retail Energy Business to Exelon is Credit Positive," July 31, 2014.

[31] "Research Update: Wisconsin Energy And Integrys Ratings Affirmed On Announced Merger; Certain Outlooks Revised To Negative From Stable", Standard and Poor's Ratings Direct, June 23, 2014, at 3.

[32] Ibid., at 6.

of the utility operating subsidiaries WEPCO and WG are unaffected by the Transaction.[33] Concerns among rating agencies regarding additional debt at the holding company is not uncommon after a merger is announced. For example, in the pending merger between Exelon Corp. and Pepco Holdings, Fitch noted that the proposed acquisition would result in a meaningful increase in consolidated leverage compared to Exelon's current and projected stand-alone financial condition.[34] S&P also noted that the New York Public Service Commission was concerned with the level of debt that National Grid was taking on to acquire KeySpan.[35]

My overall conclusion is that any short-term Credit Rating Agency concerns with increased debt at the holding company level to finance a portion of the Transaction is not a concern for the utility operating companies of the planned WEC Energy Group. The Credit Rating Agencies agree that the Transaction provides long-term benefits through enhanced financial strength of the combined company and geographic/operational diversification that will offset those short-term concerns.

V. MERGER APPROVAL STANDARDS

Q. What is your understanding of the merger approval requirements in Illinois?

A. The Commission reviews proposed "reorganizations" by public utilities in Illinois under Section 7-204 of the Public Utilities Act. This section of the Illinois statutes provides seven primary requirements that must be met in order for the merger to receive Commission approval.

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[33] "Fitch places Wisconsin Energy on Rating Watch Negative after Integrys deal announcement," SNL Financial, June 25, 2014.

[34] SNL Financial: "Fitch, Moody's, S&P weigh in on Exelon-Pepco deal," May 1, 2014.

[35] SNL Financial: "S&P downgrades National Grid and KeySpan A to A-," August 24, 2007.

Q. Does the Commission also review the allocation of any savings resulting from the proposed merger?

A. Yes, it does. Subsection 7-204(c) states:

> The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how those costs will be allocated.

Q. Has the Commission previously approved similar utility holding company mergers?

A. Yes, it has. In December 2011, for example, the Commission approved AGL Resources' acquisition of Nicor, Inc. In support of that reorganization, the Joint Applicants explained that the merger would combine the second and third largest natural gas distribution companies in the United States and would create one of the lowest-cost, most diversified families of natural gas utilities in the country, guided by a seasoned and well-respected management team. The Joint Applicants stated that Nicor Gas customers would benefit as Nicor Gas would share best practices with its affiliated utilities and realize the positive impacts of greater scale. Further, the Joint Applicants stated that AGL Resources had strong investment grade credit ratings and substantial financial resources, and that AGL Resources would give Nicor Gas a larger financial platform for making investments to maintain safety and improve reliability and customer service. The Joint Applicants indicated that Nicor Gas' customers would continue to enjoy excellence in customer service.[36]

[36] Illinois Commerce Commission, Docket No. 11-0046, December 7, 2011, Order at 4.

AGL Resources and Nicor pledged (with certain exceptions) not to seek authorization to alter Nicor Gas' base rates during the three years immediately following closure of the proposed merger. In addition, AGL Resources and Nicor committed to maintaining the level of full-time equivalent employees across Nicor Gas' service territory for a period of at least three years.[37]

VI. BENEFITS OF THE TRANSACTION

Q. Please describe the benefits that will result from the Transaction.

A. The Transaction will create benefits to customers, shareholders and the public in the following categories: (1) financial, (2) diversification, (3) operations, (4) long-term efficiencies, and (5) strategic.

Q. Please discuss the financial benefits of the Transaction.

A. The proposed Transaction will result in a larger combined company with a broader scope and more diversified yet still complementary operations and geography across its utility subsidiaries. As discussed earlier in my testimony, following the Transaction WEC Energy Group is expected to be the 14th largest utility in the country in terms of market value serving approximately 4.3 million customers across Wisconsin, Illinois, Michigan and Minnesota. This increased scale and scope will create a financially stronger company with both greater financial liquidity and improved access to capital markets. Greater liquidity enables a company to better withstand economic and financial downturns. This important financial strength will also enable WEC Energy Group to compete with other larger companies for capital on reasonable terms and conditions over the long-term.

[37] Ibid.

Q. Is the ability to compete for capital important?

A. Yes. The ability to secure capital on reasonable terms and conditions is critical for all companies, but is highly important for utilities that face increased needs to make capital expenditures associated with improvements to existing infrastructure. The access to and cost of capital directly reflects the financial strength and risk profile of the company. A stronger utility is able to pass along to its customers the benefits of lower-cost debt and assured access to capital markets on reasonable terms. If tight capital markets were to return, this access can be very valuable.

As I noted earlier in my testimony, consolidation in the utility industry was previously driven by the mergers of large companies. Now many small and medium size utility companies are finding that mergers which allow them to increase their size and financial strength are important in order to allow them to continue to have access to capital markets on reasonable terms to finance the ongoing capital needs associated with serving their customers. This is one of the motivations for and benefits of the proposed merger of WEC and Integrys. Peoples Gas and North Shore Gas each have long-term capital expenditure plans which will require them to access the financial markets for many years to come.

Q. Will the Transaction benefit Peoples Gas and North Shore Gas near-term capital projects?

A. Yes. In the near term, the strong cash flows of the combined company can fund investments in needed energy infrastructure, including environmental retrofits, gas main replacements and investment in new technologies. In particular, Peoples Gas is engaged in a 20-year accelerated main replacement program in the City of Chicago that began in

2011 and that will require significant ongoing capital investment. After the Transaction is completed, WEC has committed to maintain the current main replacement program and WEC Energy Group may be able to deploy its strong cash flows to fund those types of projects. As a result, Peoples Gas may be able to complete more of its planned investment program using internally generated cash flow than it would absent the Transaction. The ability to use internally generated cash flow to fund these near-term investments would allow Peoples Gas to avoid incremental costs and fees that would otherwise be incurred if it needed to secure financing from the markets.

Q. What are the diversification benefits to the Transaction?

A. First, let me explain what diversification is and how it provides benefits to customers and shareholders. Diversification is akin to the concept of "not putting all of your eggs in a single basket". By bringing together two different but complementary entities, one creates a whole that is more valuable and lower risk than the sum of its parts, in terms of its ability to manage its business and create and capture value over the long-term. WEC and Integrys have positioned themselves to do just that with the Transaction.

Based on my review of the terms of the Transaction, and my experience advising utility clients, the Transaction will add diversity by bringing together the Companies' complementary (1) geographies and service territories, (2) customer bases, (3) electric and gas operations, and (4) markets. Diversifying the combined company's business across these areas contributes to the creation of a stronger combined company by enabling it to better manage and balance the business across its operating companies. As I discuss later in my testimony, while no immediate net savings from efficiencies are anticipated, the Transaction unlocks the opportunity for increased efficiencies in operations, purchasing, and corporate services over the long-term. Finally, this diversification will also allow WEC Energy Group to maintain a strong financial position over the long-term.

Q. What operational benefits will the Transaction create?

A. The Transaction will create a combined company with the operational expertise, scale and resources to ensure that Illinois customers continue to enjoy adequate, reliable, efficient, safe and affordable service. The combined company will share best practices in distribution operations, large capital project management, electric generation, gas supply, system reliability and customer service across the various operating companies in Illinois, Wisconsin, Michigan and Minnesota. For example, WEPCO and WG have consistently been ranked near the top of its peer group in terms of reliability and customer satisfaction, earning recognition from PA Consulting group for excellence in reliability and from J.D. Power for both residential and business customer satisfaction. Integrys has also been a leader in developing and implementing gas infrastructure modernization projects in an urban environment. These best practices will be shared across WEC Energy Group.

As I noted earlier and as I will discuss in more detail later in my testimony, each of the operating companies will continue as individual utilities; however, there will still be opportunities to optimize their joint resources over time. For example, after the completion of the Transaction, there may be opportunities for joint resource planning based upon a combination of WEPCO's and WPS's generating portfolios, and WG's and the Gas Companies' supply and transportation portfolios that may create opportunities and efficiencies, if such coordination makes sense for the Companies and their customers.[38]

The system-wide implementation of resource planning which will result from the Transaction is also very supportive of environmental stewardship. Resource diversity, clean energy development, renewables integration, gas supply planning, and infrastructure (both electric and gas) modernization are all better achieved through the combined company.

In addition, by joining two electric workforces in adjacent service territories and two gas workforces in neighboring areas, the integrated system's ability to respond to major storms and other events that may disrupt service will be enhanced. WEC Energy Group's larger pool of field personnel and equipment will enable it to respond promptly and effectively to service interruptions.

Finally, the combined company will also be better able to attract and retain employees by offering them better career opportunities. This creates operational benefits as well as benefits for the workforce and the public.

Q. Will the Transaction create efficiencies and savings for customers over the long-term?

A. Yes. The combination of increased size and scope of the combined company and the operational and diversification benefits of the Transaction, also create opportunities for efficiencies and savings over the long-term. As also discussed in the testimony of Mr. Leverett, however, no meaningful net savings are expected in the near-term.

[38] No "dispatch" savings are expected because all generation will continue to be dispatched by Midcontinent Independent System Operator ("MISO").

Q. Is it reasonable that WEC does not expect immediate savings resulting from the Transaction?

A. Yes, this is completely reasonable. Short-term savings seen in many mergers are typically the result of immediate layoffs. WEC expects that the vast majority of reductions in utility staffing will come from natural attrition over the course of time. In particular, WEC has committed to maintain 1,953 FTE employee positions in the State of Illinois for two years following the financial closing of the Transaction and will honor the Gas Companies' worker training programs for that same time period. The Gas Companies will also honor their existing labor agreements. These commitments will minimize disruptions to the workforce and the local communities and will allow the combined company the time necessary to develop, implement and realize the benefits of a prudent integration plan. As I noted earlier in my testimony, many mergers have been consummated without the filing of a specific synergy savings analysis and with a primary focus on other drivers. This list includes:

- AltaGas Ltd. acquisition of SEMCO Holding Corporation
- AGL Resources Inc. acquisition of Nicor Inc.
- PPL Corporation acquisition of E.ON U.S. LLC
- Fortis Inc. acquisition of UNS Energy Corporation
- Integrys acquisition of Minnesota Energy Resources Corporation from Alliant Energy Corporation
- MidAmerican Energy Holdings Co. acquisition of NV Energy Inc.
- TECO Energy, Inc. acquisition of New Mexico Gas Company
- The Laclede Group, Inc. acquisition of Alabama Gas Corporation

- Macquarie Infrastructure acquisition of Duquesne Light Company
- MidAmerican Energy Holdings Co. acquisition of PacifiCorp
- AGL Resources Acquisition of NUI Corporation

Q. How might WEC Energy Group generate savings over time?

A. Merger-related savings typically accrue over time, and after upfront investment, through enhanced purchasing power, economies of scale, joint resource planning over a larger and more diverse system, the documentation, adoption and implementation of best practices, other efficiencies in operations and maintenance and project management, sharing administrative and other services over a larger organization, and the improved use of technology. Some specific areas where merger synergy savings are typically found include: insurance, shareholder services, professional services (e.g., accounting, legal), credit facilities, advertising, and supply chain economies (e.g., procurement, inventory, and contract services).

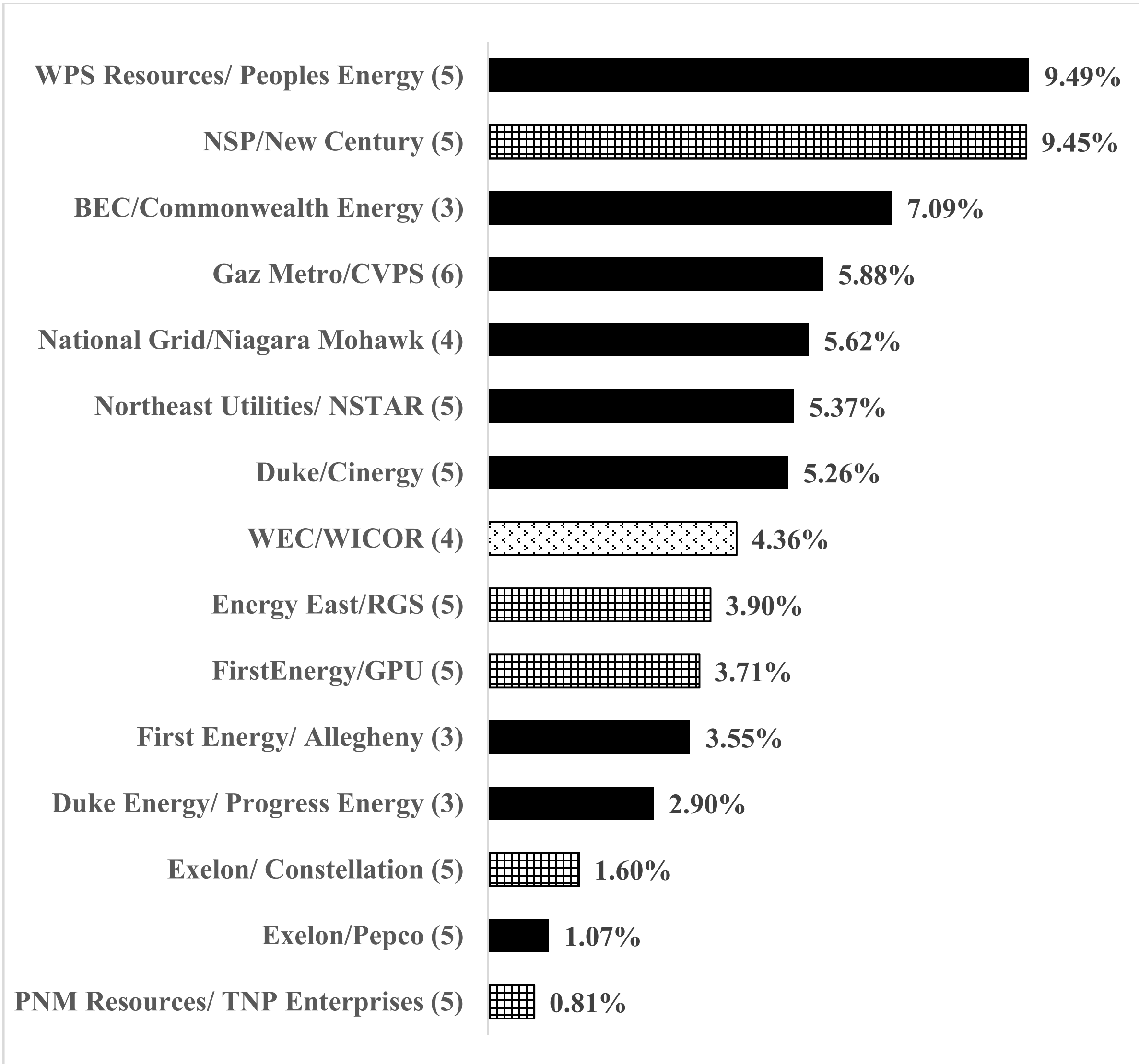
Developing and executing merger integration plans and identifying and realizing synergy savings is a detailed undertaking which takes time to accomplish, particularly in strategic mergers like the Transaction.

Q. What is your view of the merger synergy savings which might be realized from the Transaction?

A. I believe that if it is approved as proposed, the Transaction is likely to generate net savings in the range of three to five percent of non-fuel O&M of the combined company after a five to ten year ramp up period relative to what non-fuel O&M for the Companies would have been absent the Transaction.

While neither the Companies nor I have conducted a detailed analysis of the potential merger synergy savings specific to the merger of WEC and Integrys, I have examined the synergy savings attributable to many other mergers. My view on the savings which might be realized from the Transaction is based on this examination as well as my knowledge of the Companies, their past merger integration activities, and merger synergy savings generally. Below is a chart showing the non-fuel O&M savings that were, or were expected to be, achieved in other recent mergers. These savings are net of the transition-related costs to achieve them, which may include various reorganization and integration costs.

Chart 3: Survey of Historical Synergy Savings



Note: Synergy savings represent steady-state non-fuel O&M savings, net of costs to achieve. Parenthetical after each transaction signifies the assumed number of years necessary to achieve steady-state synergy savings. For mergers represented by checkerboard bars, only cumulative savings data was available and an annual savings value was estimated by taking the average annual savings over the forecast period provided. For the WEC/WICOR merger, synergy savings are actual savings as calculated after the merger was completed, and as filed with the Wisconsin PSC.

As shown in the chart above, expected net savings in non-fuel O&M in recent transactions have a central tendency in the range of 3% to 5% of combined non-fuel O&M. As I noted earlier, savings are realized after upfront investment. The mergers shown in Chart 3 were not expected to typically generate net O&M savings immediately after the merger closed, and those savings were expected to increase to a "steady state" level over a period of years.

In addition to potential non-fuel O&M savings, the Transaction can also be expected to favorably affect capital expenditures and fuel costs over the longer term. Capital expenditure savings can occur through the consolidation or avoidance of spending in areas such as IT systems and call center systems, and fuel savings have been demonstrated through joint procurement and asset management programs, which could occur here in gas pipeline and storage initiatives. On the gas side, the combined company could also be more effective in promoting the development of new pipeline infrastructure into the region and securing more economical negotiated rates for transportation services.

In considering this information, it is important to recognize that each of WEC and Integrys has been involved in other mergers which have already yielded merger savings (in the case of Integrys, recently), and WEC has made post-merger commitments that will slow the rate at which new merger synergies can be achieved.

Q. Why is it reasonable to expect that this level of savings will eventually be achievable for the WEC Energy Group?

A. Both WEC and Integrys have successfully completed integration programs after past mergers, and both had actual or estimated synergies that are in the same range as those I have estimated for this merger. The Transaction also has characteristics that are consistent with other recent mergers that had estimated long-term synergies in this range, including the Northeast Utilities/NSTAR merger. That merger was also not undertaken based on an expectation of large near-term merger synergies, and it expected longer-term savings of approximately 5% of non-fuel O&M costs, based on the existence of two overlapping utility services (gas and electric), adjacent service areas, and supportive regulatory environments. In my opinion, these same characteristics apply to the current Transaction.

Q. Has WEC provided any assurances regarding the potential for cross-subsidization within WEC Energy Group?

A. Yes. As I noted earlier in my testimony and as discussed in more detail in Mr. Lauber's testimony, WEC plans to enter into new affiliate interest agreements that reflect the merger and allow WEC and Integrys companies, including WBS, to provide services to one another where it is in customers' best interests to do so. Further, WEC has proposed no changes to the corporate structure of any of the combined company's individual operating utilities as a result of the Transaction. Each of the individual operating utilities will continue to maintain unique capital structures, costs of capital and financing requirements. These proposals will allow the utilities to benefit from efficiencies gained through the merger and a common service company, while continuing to reflect the cost of service for each of the individual operating utilities in customer rates.

Q. What plans does WEC have to specifically identify and pursue savings?

A. WEC plans to develop and execute specific merger integration plans over time. Merger integration plans identify the company-specific (1) opportunities to benefit from natural synergies resulting from the merger, increase efficiencies and generate specific savings, (2) costs to achieve these savings, and (3) timeframe and process for achieving the plan. The development and execution of merger integration plans is a multi-year process involving management and internal and external subject matter experts throughout the combined company. WEC is not planning any significant reductions in force or layoffs and associated near-term merger-related savings and it has not yet begun the integration process.

Q. What are the strategic benefits of the Transaction?

A. The Transaction will create a large, diversified, financially strong energy company committed to providing long-term strategic benefits to customers, employees, shareholders, and the communities served by WEC Energy Group's utility subsidiaries. WEC Energy Group will continue to maintain a strong local presence in the communities it serves, with operational headquarters being maintained for Peoples Gas in Chicago, Illinois and for North Shore Gas in Waukegan, Illinois. In addition, larger and more efficient utilities should be expected to lead to lower energy costs, which can be expected to, in turn, favorably affect industrial and commercial siting decisions. Customers of Peoples Gas and North Shore Gas, employees and the local communities and State will continue to benefit from the positive impacts of these attributes on service, corporate citizenship and the local economy. WEC Energy Group will also carry on the long tradition of its predecessor companies of active involvement, philanthropic activities and charitable contributions in the communities it serves. This, coupled with the combined companies increased diversification and operational opportunities, will produce significant local and regional economic benefits as compared to either continued independent operation or as part of a different merger with a different acquirer whose focus may be broader than Illinois and the region.

Finally, the scale, operational expertise and financial resources of WEC Energy Group will equip it to more effectively represent the interest of the states in which it operates and maintain its independence in a consolidating industry. A strong State and regional voice in national energy policy debates is a significant benefit to ensuring that these interests are both well-represented and heard. One example of such an energy policy debate is how greenhouse gas ("GHG") regulations will be implemented by the states and the federal Environmental Protection Agency ("EPA"). A stronger voice in this debate will better position Illinois and the region to influence rules that reflect its resource base and needs. The creation of WEC Energy Group creates incremental opportunities for the combined company and the Commission to partner in the pursuit of energy policy goals and to meet the region's future energy needs.

Q. Will the Transaction negatively impact competition in the region?

A. No. This merger is a purely strategic undertaking, representing the union of two companies that are almost entirely regulated utilities. The Transaction will not lessen competition as can occur when meaningful unregulated activities are consolidated (e.g., merchant generation, coal mining, gas production). WEC's proposal with regard to new affiliate interest agreements obviates any concern about the potential for cross-subsidization of utility and non-utility operations. Unlike some financially-oriented mergers (e.g., private equity acquisitions, international acquirers, and leveraged buy outs) there is no need for elaborate ring fencing protections.

VII. HOW THE TRANSACTION SATISFIES THE COMMISSION'S MERGER APPROVAL STANDARDS

Q. Please highlight the Commission's merger approval standards.

A. In order for the Commission to approve a reorganization, the Commission must determine that there is "no net harm" to utility customers or the general public as a result of the merger. As described in more detail in Section IV of my testimony, the Commission shall approve a reorganization if it finds that the reorganization will not adversely affect the utility's ability to perform its duties under the Public Utilities Act. Specifically, the reorganization must satisfy seven specific requirements outlined in Section 7-204.

Q. Do you believe that the Transaction will diminish the ability of Peoples Gas and North Shore Gas to provide adequate, reliable, efficient, safe, and least cost public utility service?

A. No, I do not. On the contrary, the Transaction will help to ensure that Peoples Gas and North Shore Gas (collectively, the "Gas Companies") are able to continue to provide adequate, reliable, efficient, safe, and least cost public utility service. In particular, as a result of the Transaction, the Gas Companies will have enhanced access to capital on reasonable terms to finance their capital investment requirements. For example, after the Transaction is completed, WEC Energy Group may be able to deploy its strong cash flows to help fund Peoples Gas' Accelerated Main Replacement Program ("AMRP"). This would be a direct benefit to Illinois customers. As discussed in the pending rate case, Peoples Gas' AMRP benefits customers through enhanced reliability and safety, reduced maintenance costs by eliminating low pressure regulating stations, increased convenience by relocating gas meters from inside the customer premises to outdoors, and reduced greenhouse gas emissions due to fewer leaks.[39]

In addition, while the Transaction is not based on immediate synergies or cost savings for customers, the combined companies expect that sharing best practices across

[39] See Direct Testimony of David J. Lazarro, Docket No. 14-0225, filed February 26, 2014, at 15-16.

the various operating utilities may lead to cost reductions and customer savings over time. For all of these reasons, my view is that the Transaction meets, and in fact exceeds, the first statutory requirement in Illinois.

Q. Why do you believe that the Transaction will not result in unjustified subsidization of non-utility activities by the Gas Companies or their customers?

A. As explained in the testimony of WEC witness Lauber, the applicants have taken steps to ensure that the Transaction will not result in unjustified subsidization of non-utility activities by the Gas Companies or their customers. Specifically, the Companies plan to enter into new affiliate interest agreements that reflect the merger and allow WEC and Integrys companies, including WBS, to provide services to one another where it is in customers' best interests. Further, the Companies have proposed that there be no changes to the corporate structure of the individual operating utilities as a result of the Transaction. Peoples Gas and North Shore Gas will continue to maintain unique capital structures, costs of capital and financing requirements. On this basis, I believe that the Transaction meets the second statutory requirement in Illinois.

Q. Is there evidence that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such manner that the Commission may identify those costs and facilities which are not properly included by the utility for ratemaking purposes?

A. Yes, there is. As discussed in more detail in the testimony of WEC witness Lauber, the applicants have taken steps to ensure that once the Transaction is completed, costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such manner that the Commission may identify those costs and facilities which are not properly included by the utility for ratemaking purposes. In my view, the applicants have taken the steps necessary to ensure compliance with the third statutory requirement in Illinois.

Q. Do you believe that the Transaction will not significantly impair the Gas Companies' ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure?

A. Yes. In fact, my view is that the Transaction will actually enhance the Gas Companies' ability to raise necessary capital on reasonable terms because the combined company will be able to compete with larger utility companies in capital markets. The financial strength of the combined company is apparent to investors, as evidenced by strong cash flows, a strong balance sheet, enhanced earnings growth, higher dividend payments, and strong investment grade credit ratings for the parent holding company and the operating utility companies. This financial strength will also ensure that the Gas Companies have a balanced risk profile, which will allow the Gas Companies to maintain a reasonable capital structure. Credit Rating Agencies have reaffirmed the ratings for the operating companies after the Transaction is completed, and Moody's has indicated that Integrys' rating could be upgraded once Integrys completes the sales of its retail energy services business. For all of these reasons, I believe that the Transaction meets the fourth statutory requirement in Illinois.

Q. Will the Gas Companies remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities?

A. Yes, they will. As stated in the Application and in Mr. Leverett's testimony, after the Transaction is completed, the Gas Companies will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. Further, WEC is not proposing any changes to the legal structure of any of the operating utilities, including the Gas Companies, that will operate under the WEC Energy Group umbrella and that are currently subject to the jurisdiction of the Commission. Given those representations, I conclude that the Transaction meets the fifth statutory requirement in Illinois.

Q. What evidence is there that the Transaction is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction?

A. The retail gas market in Illinois has been open to competition since 2002, with all customers having the ability to choose their gas supply company. Peoples Gas and North Shore Gas provide retail gas distribution service to customers that do not select an alternative gas supplier through their company-owned facilities, and gas delivery service to customers who have chosen a third-party gas supply company. The Transaction will not have any adverse effect on competition in markets over which the Commission has jurisdiction because the Gas Companies' customers will continue to have the opportunity to purchase their gas from an alternative supplier.

Additionally, Integrys expects to have completed the divestiture of its non-regulated energy marketing subsidiary, IES, well before the closing of the Transaction. Further, the Transaction is being reviewed by other governmental entities for, among other things, competitive issues falling outside the Commission's jurisdiction. For all of these reasons, I believe that the Transaction meets the sixth statutory requirement in Illinois.

Q. Why do you believe that the Transaction is not likely to result in any adverse rate impacts on the Gas Companies' retail customers in Illinois?

A. As discussed earlier in my testimony, the Transaction will not result in any immediate rate changes or rate consolidation for customers of Peoples Gas or North Shore Gas. In fact, the applicants are proposing that Peoples Gas and North Shore Gas will not seek increases of their base rates that would become effective earlier than two years after the Transaction closes, which is not likely to occur prior to July 2015. The effect of this commitment, therefore, will be that the Gas Companies' new rates will be fixed for a period of well over two years. Thereafter, the Gas Companies' customers will receive all achieved savings, if any, as reflected in the Gas Companies' test year costs in their future base rates. Therefore, there will not be any adverse rate impacts on the Gas Companies' retail customers in Illinois as a result of the Transaction.

In addition, while the Transaction is not based on immediate synergies or cost savings for customers, the applicants expect that sharing best practices across the various operating utilities may lead to cost reductions, which would be reflected in future test year cost of service and thus benefit customers over time. Further, the financial strength of the combined company will allow it to compete for capital in financial markets on reasonable terms. Any reduction in the market-based cost of capital as a result of the Transaction would also flow through to customers in future rate cases. For all of these reasons, I believe that the Transaction meets the seventh statutory requirement in Illinois.

Q. Please explain how the Transaction satisfies the requirements of subsection 7-204(c).

A. Subsection 7-204(c) requires the Commission to rule on (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how those costs will be allocated.

As explained throughout my testimony, the Transaction does not result in any immediate net savings. Any savings that occur as a result of the Transaction, net of the costs to achieve them, are expected to materialize over the longer-term (e.g., 5 to 10 years after closing). Further, WEC is not seeking recovery of any costs incurred to accomplish the Transaction or any portion of the acquisition premium.

Q. If these synergies or savings are achieved, will the benefits be seen by the customers of the operating companies?

A. Yes, they will, as these savings are achieved over the longer term. As I mentioned earlier, there are not immediate rate impacts expected from the merger. However, the shared services model of the WEC Energy Group (as reflected in the proposed affiliate interest agreements) will have the effect of eventually reducing administrative costs across the entire merged company, and each operating company's share of these net savings will be reflected in their cost of service in future rate filings. My experience with other mergers also indicates that these savings can help delay the need for future rate increases. Therefore, each operating company's customers will benefit from the merger, as savings are unlocked over the longer term. For these reasons, I believe that the Transaction satisfies the requirements of Subsection 7-204(c) of the Public Utilities Act in Illinois.

Q. Has WEC proposed any conditions to the Transaction?

A. Yes. As explained in more detail in Mr. Leverett's testimony, WEC has proposed the following commitments, which the Commission could adopt as conditions to its approval of the Transaction:

1. WEC Energy Group will not seek the inclusion of any portion of the acquisition premium in the Gas Companies' rate bases, nor the amortization of the premium in future cost of service determinations.

2. WEC Energy Group will not seek recovery of any costs incurred to accomplish the reorganization.

3. From the date the reorganization closes, WEC Energy Group commits that the Gas Companies will not seek increases of their base rates that would become effective earlier than two years after the financial closing of the Transaction. The effect of this commitment will be that the Gas Companies' new base rates will be fixed for a period of well over two years after they are expected to become effective in their pending rate cases.

4. WEC Energy Group will maintain at least 1,953 full-time equivalent employee positions in the State of Illinois for two years following the financial closing of the Transaction**.**

5. WEC Energy Group will honor the Gas Companies' existing labor agreements.

6. For at least two years after the financial closing of the Transaction, WEC Energy Group will maintain all of the Gas Companies' existing training programs, including those designed to ensure compliance with pipeline safety requirements in their current format. For the same time period, the Gas Companies will maintain their commitments to the gas workers degreed training program.

7. WEC Energy Group is committed to having Peoples Gas continue the AMRP assuming that the legislatively authorized rider – Rider QIP – remains in effect to allow automatic recovery on AMRP investments up to a percentage cap of Peoples Gas' base rate revenues each year, as well as WEC Energy Group and Peoples Gas remaining financially capable of doing so.

8. WEC Energy Group will carefully review the results of the Commission's audit of the Peoples Gas AMRP and will ensure that

Peoples Gas works to coordinate with the City of Chicago in the execution of the AMRP.

9. WEC Energy Group will work with interested stakeholders to develop recommendations for Peoples Gas' energy efficiency programs.

10. WEC Energy Group commits to honoring the Gas Companies' existing philanthropic pledges, and thoughtfully considering future charitable requests, with the objective of supporting those causes that will most benefits the Gas Companies' customers and their communities.

11. WEC Energy Group is willing to commit to having at least one non-employee resident of Illinois on the board of directors of the post-reorganization company.

12. WEC Energy Group is committed to bringing its Supplier Diversity Initiative to the Gas Companies in Illinois.

Q. Is the Transaction in the public interest?

A. Yes. For all of the reasons discussed in my testimony, the Transaction will provide Peoples Gas and North Shore Gas ratepayers numerous benefits and contains provisions which will assure that these benefits will continue to inure to the public in the future. In addition, Illinois citizens will benefit from a larger, more diversified, and financially strong energy company that is committed to serving the needs of the communities in which it operates.

Q. In your opinion, does the Transaction satisfy the Commission's merger approval standards?

A. Yes, it does.

VIII. CONCLUSIONS AND RECOMMENDATIONS

Q. Please summarize your conclusions and recommendation.

A. If approved, this Transaction will allow the formation of a utility holding company with the strength, breadth, operational expertise, and local and regional commitment that will create benefits for customers, investors and the public now and for the long term. This company will act as a leader in the energy industry and will continue to constructively contribute to critical decisions affecting energy policy in Illinois. Importantly, these benefits will not occur without the Transaction. I recommend that the Commission approve the Transaction as proposed.

Q. Does this conclude your testimony?

A. Yes, it does.